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No. 884

In the Supreme Court of the United States

OCTOBER TERM, 1960

WEST VIRGINIA NORTHERN RAILROAD COMPANY,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 1a–9a)[1] are not officially reported. The opinion of the Court of Appeals (Pet. App. 13–17) is reported at 282 F. 2d 63.

JURISDICTION

The judgment of the Court of Appeals was entered on September 19, 1960. Its order denying taxpayer's petition for rehearing was entered January 10, 1961. The petition for a writ of certiorari was filed April 7,

[1] Record references are to the appendix to taxpayer's brief in the court below.

1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the two courts below were correct in finding that certain payments made by the taxpayer-corporation did not constitute ordinary and necessary rental expense of the corporation, but, rather, constituted payments for personal obligations of the corporation's sole stockholder, and, thus, were not deductible under Section 23(a)(1)(A) of the Internal Revenue Code of 1939.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 23 [as amended by Sec. 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 819]. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—
>
> (1) *Trade or business expenses.*—
>
> (A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including * * * rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.
>
> * * * * *
>
> (26 U.S.C. 1952 ed., Sec. 23.)

STATEMENT

The taxpayer-corporation is a railroad company which, during the tax years in question, operated eleven miles of track in West Virginia as a feeder of the Baltimore & Ohio Railroad Company. Up until 1951, the entire stock of the taxpayer was owned by James Jenkins and his four children, 600 shares by him and 100 shares each by the children. The Jenkins family also owned two Diesel locomotives which they had been leasing to the railroad at a rental of seven and one-half cents per freight-ton hauled. These locomotives were the sole motive power for the railroad. The family also owned 2,500 acres of coal land in Preston County, West Virginia. (Pet. App. 13.)

On December 30, 1950, the Jenkins family granted an option to the Preston Coal Company, exercisable on or before July 1, 1951, to purchase all of the taxpayer's stock for $500,000, of which $50,000 was payable in cash and the balance in fifteen annual installments. The option also provided that the purchaser was to take a twenty-five-year lease of the locomotives at the seven and one-half cents per ton rate and that there was to be no adverse change in the taxpayer's financial condition and no change in the capital structure during the option period. It was further provided that, in the event the coal company exercised the option, it would be required to exercise a second option to purchase the family's coal land at $50 per acre or, alternatively, to lease it at a royalty of ten cents per ton of coal mined and sold. The minimum royalty was to be $30,000 per year. (Pet. App. 13–14.)

On March 19, 1951, the coal company assigned its right in both options to Ralph R. Lewis, who, on or before July 1, 1951, notified the Jenkins family of his intent to exercise the options. (Pet. App. 14.)

Subsequently, James Jenkins notified Walter Biddle Saul, the attorney for Lewis, of his dissatisfaction with the terms of the options, particularly that the stock was to be turned over to Lewis upon receipt of the $50,000 down payment without any note or other security for the payment of the installments. (Pet. App. 14.) Among other changes, Saul agreed to give a note to secure payment of the balance of the purchase price after the initial $50,000, the stock to serve as collateral for the note. It was further agreed that on settlement the Jenkinses would lend Lewis $90,000 to cover (1) the initial payment on the stock, (2) a $20,000 initial payment on the coal property lease, Lewis having chosen to lease rather than purchase that property, and (3) $20,000 to meet the expenses of sale. The $90,000 was to be added to the $450,000 balance due on the stock purchase, making the total amount due on the note $540,000. (R. 4a.)

James Jenkins also asked that the locomotive rental be increased to twelve and one-half cents per freight ton and that the lease period be reduced from twenty-five to fifteen years, with the taxpayer having the right to terminate the lease by purchasing the locomotives outright for $387,500 in cash. Saul refused to agree to the latter demand, since the original agreement already established the rental rate at seven and one-half cents per ton and provided that the taxpayer's financial position should not be materially

worse at settlement than when the options were executed. Saul considered that the proposed rental increase would reduce the value of the taxpayer's stock and that therefore the price Lewis would have to pay for that stock would have to be reduced accordingly. The Jenkins family finally agreed. (R. 4a–5a.)

A provision was added to the agreement to the effect that the rental to be paid by the corporation for the locomotives should be fixed at twelve and one-half cents instead of seven and one-half cents per ton, as contemplated in the original agreement, and that the additional five cents per ton should be credited against any installment payment due by Lewis on the purchase price of the stock of the railroad, and, if no installment was due, then the additional five cents per ton should be credited against the minimum royalty due by Lewis under the lease of the coal lands. (Pet. App. 14–15.)

For the years in question the following sums were paid or accrued by the taxpayer under the amended rental agreement (Pet. App. 15):

Taxable year	Amount at 7½-cent rate	Amount at 5-cent rate
1941	$53,500.86	$19,982.69
1942	56,170.83	35,407.94
1943	45,969.20	29,500.43

The amounts represented by the five cents per ton factor during each of these years were credited against the installment due from Lewis on his stock purchase note. (Pet. App. 15.)

On its income tax returns for the years in question, the taxpayer deducted the full amount of the pay-

ments made at the twelve and one-half cents rate as locomotive rent; the Commissioner disallowed the portion representing the additional five cents per ton. (Pet. App. 15.) The Tax Court sustained the Commissioner's determination on the ground that the questioned amounts were payments by the taxpayer in satisfaction of the personal obligations of Lewis on the stock purchase rather than ordinary and necessary rental expenses of the corporation. (R. 8a.) The Court of Appeals affirmed. (Pet. 16–17.)

ARGUMENT

The question presented is one of fact, and the evidence supports the determination of both courts below. These concurrent findings are final in the absence of a very exceptional showing of error. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214. The case does not conflict with any prior decision of any court of appeals or of this Court, and there is no other reason for further review.

The factual question posed is whether certain payments made by the taxpayer-corporation were truly intended by the parties as rental on locomotives used in its railroad business or as payments against the personal obligation of the sole corporate stockholder on the purchase price of the stock. This Court has consistently declined to review questions of this type and has denied certiorari in a case in which an almost identical issue was involved. *Brush-Moore Newspapers, Inc.* v. *Commissioner*, 95 F. 2d 900 (C.A. 6th), certiorari denied, 305 U.S. 615.

1. The taxpayer rests its petition (Pet. 9) upon the contention that both the Tax Court and the Fourth Circuit have decided a federal question in conflict with the provision of Section 23(a)(1)(A) of the Internal Revenue Code of 1939, *supra*, p. 2, and thereby have misinterpreted the statute. The taxpayer further states (Pet. 10), however, that "[i]f the expenses of a taxpayer are *in fact* rentals, constituting ordinary and necessary business expenses, then the statute requires that they shall be allowed as deductions * * *." (Emphasis added.) By using the words "in fact", the taxpayer states the sole issue that was decided below. In passing upon that issue, the courts below had no occasion to pass on any question of statutory interpretation. The Tax Court pointed to the basis for its decision when it said (R. 7a), "The character of the payments in issue must be determined from the intentions of the parties as evidenced by the agreements between them." The purely factual nature of the question was also recognized by the Court of Appeals which, in affirming, declared that "there was ample ground for the finding of the Tax Court" and pointed out that the taxpayer's argument was without validity since it was confined to facts which "constitute only a part of the picture." (Pet. App. 16.)

2. There is ample evidence in the record to support the finding of both courts that the payments disallowed as deductions were not intended as rental on the locomotives but were rather a device for the payment of a personal obligation of taxpayer's sole stockholder.

(a) The stockholder, Lewis, categorically rejected the demand by the Jenkins family for the increased rental rate, insisting that any amount to be paid by the taxpayer to the Jenkinses in excess of the original seven and one-half cents per ton rate had to be applied to his obligation on the purchase price of the stock. He consented to call these amounts "rentals" but insisted that they be treated as something else. (See the Statement, *supra*, pp. 4–5.)

(b) The amended agreement further provided that, where no installment payment was due on the purchase price of the stock when the monthly "rental" payment became due, the amount of the latter attributable to the five-cent factor was to be applied against the minimum royalties due on the coal land lease. (See the Statement, *supra*, p. 5.) This circumstance refutes taxpayer's contention (Pet. 10) that the additional "rental" payments were intended only as a means of "measuring the price ultimately to be paid for the railroad."

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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